Chairman's Statement

The Year's Results

The Group's town gas business in Hong Kong maintained stable growth in 2016. Global economic fluctuations, slowdown in economic growth in mainland China, further devaluation of the renminbi and low international oil prices during the year, however, impacted the Group's utility and emerging environmentally-friendly energy businesses on the mainland. Nevertheless, the Group endeavoured to maintain stability in its overall recurrent business results for 2016.

Profit after taxation attributable to shareholders of the Group for the year increased by 0.53 per cent to HK$7,341 million, an increase of HK$39 million compared to 2015. Earnings per share for the year amounted to HK57.7 cents.

During the year under review, the Group invested HK$6,257 million in production facilities, pipelines, plants and other fixed assets for the sustainable development of its various existing and new businesses in Hong Kong and mainland China.

Town Gas Business in Hong Kong

The local economy grew slower in 2016 compared to 2015 amid a challenging global economy. During the year, tourism was hit by a strong Hong Kong dollar causing a decrease in the total number of inbound visitors for the second consecutive year and thus negatively impacting the food and beverage gas sales market. Conversely, as the average temperature in Hong Kong in 2016 was lower than in 2015, residential gas sales increased. Compared to

2015, total volume of gas sales in Hong Kong for 2016 increased by 1.4 per cent to 28,814 million MJ while appliance sales revenue increased by 24.9 per cent to HK$1,634 million with a total of 275,361 sets sold, mainly benefiting from newly completed residential projects.

As at the end of 2016, the number of customers was 1,859,414, an increase of 20,153 compared to 2015, slightly up by 1.1 per cent.

Business Development in Mainland China

The Group's mainland businesses continued to progress steadily during 2016. Overall, inclusive of projects of the Group's subsidiary, Towngas China Company Limited ("Towngas China"; stock code: 1083.HK), the Group had 241 projects on the mainland, as at the end of 2016, 19 more than at the end of 2015, spread across 26 provinces, autonomous regions and municipalities. These projects encompass upstream, midstream and downstream natural gas sectors, water sectors, efficient energy applications and exploration and utilisation of emerging environmentally-friendly energy, as well as telecommunications.

The Group's development of emerging environmentally-friendly energy businesses in mainland China, including coalbed methane liquefaction, coal chemicals, conversion and utilisation of biomass, natural gas refilling stations, etc., through its wholly-owned subsidiary ECO Environmental Investments Limited and the latter's subsidiaries (collectively known as "ECO"), is progressing steadily. During 2016, international oil prices continued to fluctuate, falling at one time early in the year, to a 2003 low, leading to a drastic drop in prices of energy products which significantly affected ECO's profits. Nevertheless, ECO's self-developed innovative technologies progressed well in 2016. Gradual commercial application of ECO's new technologies is expected to contribute to long-term business growth of the Group. Additionally, international oil prices have become more stable since the end of 2016, and this will also help the Group's income growth.

Diversification and an increase in the number of projects have gradually transformed the Group from a locally-based company in Hong Kong centred on a single town gas business into a sizable, nation-wide, multi-business corporation focused on environmentally-friendly energy ventures and utility sectors.

Utility Businesses in Mainland China

The Group's city-gas businesses are progressing well. As at the end of 2016, inclusive of Towngas China, the Group had a total of 131 city-gas projects in mainland cities spread across 23 provinces, autonomous regions and municipalities. The total volume of gas sales for these projects in 2016 was approximately 17,140 million cubic metres, an increase of 10.3 per cent over 2015. As at the end of 2016, the Group's mainland gas customers stood at approximately 23.1 million, an increase of 11 per cent over 2015. The Group continues to have a good reputation as a large-scale city-gas enterprise with outstanding performance on the mainland.

Due to uncertainties over the policy direction of a number of major global economies resulting in poor growth momentum, demand for commodities worldwide remained weak during 2016, and, as a result, growth in the mainland economy slowed compared to 2015. Exports from mainland China have now declined for two consecutive years. Cutting excessive capacity, destocking and deleveraging have also reduced industrial production. Thus, demand for energy across the country, including electricity, petroleum and natural gas, recorded only slight growth in 2016. Furthermore, given low international oil prices, prices for other petroleum fuels also declined. Nevertheless, in the medium to long term, as natural gas is still projected to be the clean energy of choice to best reduce air pollution and improve smoggy atmospheric conditions on the mainland, long-term and steady growth in demand is still anticipated. The Chinese government has also formulated a natural gas utilisation policy to strengthen preventative measures to combat air pollution and to minimise the formation of smog, indicating an energy development trend inclining towards natural gas and environmentally-friendly energy. The competitiveness of natural gas relative to other energy sources was also enhanced following reductions in the mainland's non-residential natural gas city-gate prices at the end of 2015. This favourable momentum will continue to benefit the Group's city-gas and natural gas businesses.

In addition, with gradual commissioning of large-scale national natural gas projects, including transmission pipelines from Sichuan province to eastern and southern China and the West-to-East pipeline, and projects for importing piped natural gas from Central Asia and Myanmar, together with a scheduled supply of piped natural gas from Russia, as well as a rise in the sources of imported liquefied natural gas ("LNG"), supply of natural gas on the mainland is becoming ample, which is beneficial to market development. With a number of mainland cities gradually advocating the use of natural gas to replace coal, natural gas as a fuel for household heating in winter is steadily growing. Thus, with increasing sources of gas supply, expanding pipeline networks, rising living standards and society's aspiration for greater environmental protection, the Group anticipates its mainland city-gas businesses will continue to thrive in future.

Anhui Province Natural Gas Development Co. Ltd., an associated company of the Group, was listed on the Shanghai Stock Exchange on 10th January 2017. As a large-scale integrated operator, its core business is the construction and operation of long-haul natural gas pipelines in Anhui province, alongside a downstream distribution business. Listing will help speed up the company's construction of natural gas pipelines and its development of markets in the province.

Construction of the Group's natural gas storage facility in underground salt caverns in Jintan district, Changzhou city, Jiangsu province, is in progress. Upon completion, this facility will be the first of its kind developed by a city-gas enterprise on the mainland. Total storage capacity will be approximately 460 million standard cubic metres. Completion of phase one of this project, with a storage capacity of 150 million standard cubic metres, is expected during the second quarter of 2017. This facility, which will help the Group supplement and regulate gas supplies during the peak winter period for several of its city-gas projects in eastern China, is in line with the Chinese government's policy of advocating faster development of gas storage capacity, and will support the Group's business development in downstream city-gas markets.

The Group's development of natural gas vehicular refilling stations in mainland China, under the brand name "Towngas", is progressing well with 109 stations now spread across different provinces to date. Apart from this, the Group is also proactively developing refilling projects for marine vessels and is currently investing in a joint venture project, with six refilling sites, for barges along the Yangtze River in Jiangsu province. This is the country's first, and largest project in terms of number of refilling sites, along this river.

In September 2013, the joint venture constructed and put into service the country's first floating LNG refilling station barge. Classified by the government as a pilot project, this venture represents the start of a new era for the mainland's marine industry in LNG applications. Given that LNG is a form of clean energy that is being actively promoted by the Chinese government, vehicular and marine refilling station businesses have good prospects for the Group.

The Group has entered into the mainland water market under the brand name "Hua Yan Water" for over 11 years and currently invests in, and operates, six water projects. These include water supply joint venture projects in Wujiang district, Suzhou city, Jiangsu province and in Wuhu city, Anhui province; wholly-owned water supply projects in Zhengpugang Xin Qu, Maanshan city and in Jiangbei Xin Qu, Wuhu city, both in Anhui province; and an integrated water supply and wastewater treatment joint venture project, together with an integrated wastewater treatment joint venture project for a special industry, both in Suzhou Industrial Park, Suzhou city, Jiangsu province. In addition, given food waste processing and utilisation is also a sizable environmentally-friendly industry, the Group is constructing a plant in Suzhou Industrial Park to handle 500 tonnes of food waste, green waste and landfill leachate daily for conversion into natural gas, oil products, solid fuel and fertilizers, under the "Hua Yan Water" brand; commissioning is expected in the third quarter of 2018 and will be the Group's first project converting waste into high-value products.

Operation and management of businesses encompassing city-gas, midstream natural gas, city-water and waste processing and utilisation projects create greater synergy and mutual advantages. Furthermore, these businesses generate a stable income and provide good environmental benefits, with room for expansion. The Group will therefore keep on looking for opportunities to invest in high-quality utility projects on the mainland.

Emerging Environmentally-Friendly Energy Businesses

ECO's major businesses in Hong Kong – an aviation fuel facility, dedicated liquefied petroleum gas ("LPG") vehicular refilling stations and landfill gas utilisation projects – all operated smoothly in 2016. With a total turnover of approximately 6.2 million tonnes in 2016, ECO's aviation fuel facility provided a safe and reliable fuel supply to Hong Kong International Airport and contributed to ECO's steady profit growth. ECO's LPG vehicular refilling station business had a steady operation and satisfactory profit in 2016, providing a quality and reliable fuel supply to the territory's taxi and minibus sectors. ECO's landfill gas project in the North East New Territories, after operating for several years, has been generating noticeable environmental benefits. ECO's development of a South East New Territories landfill gas utilisation project is also progressing smoothly, with commissioning expected to start in the first half of 2017. This will then further increase the proportion of landfill gas used by the Group and make an additional contribution to energy conservation and emission reduction in Hong Kong.

With international oil prices creeping low during most of 2016, annual output of ECO's oilfield project in Thailand fell to 1.37 million barrels, causing a significant impact on profit. However, a rebound in international oil prices to a range of approximately USD55 per barrel in late 2016 helps to stabilise the business conditions faced by the project.

As smog and air pollution on the mainland are now a growing concern, the Chinese government is stepping up its efforts to promote the use of LNG to gradually replace diesel as fuel for heavy-duty trucks. ECO's networks of natural gas refilling stations are gradually taking shape in provinces and autonomous regions including Shaanxi, Inner Mongolia, Ningxia, Shandong, Shanxi, Jiangsu, Henan and Liaoning. All in all, ECO currently has 62 refilling stations in operation, under construction or at the planning stage. As expansion of its networks progresses, the ECO brand name will gradually become more well-known in the market.

Conversion of biomass into clean energy and chemical products is an important part of ECO's business strategy which is in line with the policy direction of mainland China. To this end, the plant now under construction and located in Zhangjiagang city, Jiangsu province can upgrade approximately 220,000 tonnes of palm acid oil, a low-quality inedible bio-oil, into high-value oleic acids and other chemical products each year. Construction is expected to be completed and ready for trial production by the third quarter of 2017. In addition, construction of a project in Xuzhou city, Jiangsu province to produce LNG by methanation of coke oven gas has been largely completed; trial production is expected to commence in the first half of 2017.

Mainland China, a sizeable agricultural country, generates a large quantity of agricultural waste every year. Apart from using a small portion of this in fields or for power generation, there are currently no effective measures to make good use of the rest of this waste. However, ECO's research and development team has successfully developed a world leading approach on pyrolysis and hydrolysis technologies, which can convert agricultural and forestry waste into high-value syngas and green block chemicals, such as furfural and levulinic acid. To this end, ECO has launched a pilot project in Hebei province with trial production expected to start in the second half of 2017, the success of which would pave the foundation for subsequent commercial implementation.

ECO's coal chemical project in Ordos city, Inner Mongolia Autonomous Region, operated smoothly during 2016 yielding over 310,000 tonnes of methanol. Works to upgrade and optimise the facility to convert methanol into natural gasoline are progressing as planned.

Additionally, ECO has launched a new project to convert 40 per cent of the coal-based syngas into 120,000 tonnes of higher-valued ethylene glycol, with trial production targeted to start before the end of 2017. These will lay a solid foundation for ECO to further broaden its businesses on syngas utilisation and methanol upgrading.

In line with its evolving business development strategy, ECO continues to strengthen its capabilities in research and technological development, from the original technological emphasis on fuel substitutes, now extending to encompass higher value-added chemical and new material substitutes. These include the conversion of high-temperature coal tar oil into pitch-based carbon materials, low temperature carbonisation of oil-rich powder coal, and deep-processing of levulinic acid to green fuel additives. A number of breakthroughs have already been achieved, and upon commercial application of technologies which can be proceeded shortly, significant economic and environmental benefits could be derived. All these successes will create a significant competitive edge for ECO's future development.

Towngas China Company Limited

(Stock Code: 1083.HK)

Towngas China, a subsidiary of the Group, recorded good growth in profit after taxation attributable to its shareholders, amounting to HK$974 million in 2016, an increase of approximately 21 per cent over 2015. As at the end of 2016, the Group held approximately 1,739 million shares in Towngas China, representing approximately 64.12 per cent of Towngas China's total issued shares.

Towngas China added two new distributed energy projects to its portfolio in 2016, one based in Sichuan province, and the other known as Towngas China Energy Investment (Shenzhen) Limited.

Towngas China was honoured with the Grand Award presented by The Hong Kong Management Association ("HKMA") at its 2016 HKMA Quality Awards, in recognition of the company's long-time commitment to quality. The award is highly gratifying as it affirms Towngas China's positive approach to total quality management, enhancement of performance across all its operations, and quality products and services. Towngas China's ongoing efforts to improve its customer services, safety, human resources, social responsibility, corporate governance and financial performance continue to contribute to the Group's business growth momentum and establishment of a good corporate image.

During 2016, Moody's Investors Service maintained its issuer credit rating on Towngas China as "Baa1" with a "stable" outlook. Standard & Poor's Ratings Services also upheld their "BBB+" long-term corporate credit rating and "cnA+" long-term Greater China regional scale credit rating on Towngas China with a "stable" outlook. These two international rating agencies' ratings demonstrate recognition of Towngas China's stable financial status and reflect the company's increasing credit strength.

Financing Programmes

In order to tap funding in a timely and flexible manner, the Group established a medium term note programme in 2009 under HKCG (Finance) Limited, a wholly-owned subsidiary of the Group. Taking advantage of low interest rates, medium term notes totalling HK$1,328 million, with maturity ranging from 10 to 12 years, were issued during 2016. In line with the Group's long-term business investments, as at 31st December 2016, the amount of medium term notes issued had reached HK$11.9 billion with tenors ranging from 10 to 40 years, with an average fixed interest rate of 3.6 per cent and an average tenor of 15.5 years.

Employees and Productivity

As at the end of 2016, the number of employees engaged in the town gas business in Hong Kong was 2,019 (2015 year end: 1,999), the number of customers was 1,859,414, and each employee served the equivalent of 921 customers, a similar level to 2015. Inclusive of employees engaged in local businesses such as telecommunications, LPG vehicular refilling stations and engineering contractual works, the total number of the Group's employees engaged in businesses in Hong Kong was 2,392 as at the end of 2016 compared to 2,380 as at the end of 2015. Related manpower costs amounted to HK$1,052 million for 2016. In 2016, there was an approximately 4 per cent average increase in remuneration over 2015. The Group will continue to offer employees rewarding careers based on their capabilities and performance and arrange a variety of training programmes in order to constantly enhance the quality of the Group's customer services.

Exclusive of businesses in Hong Kong, the total number of the Group's employees in mainland China and other places outside Hong Kong was 47,000 as at the end of 2016, an increase of approximately 1,400 compared to 2015.

On behalf of the Board of Directors, I would like to thank all our employees for their dedication and hard work in creating value for shareholders and customers.

Bonus Issue of Shares

The Directors propose to make a bonus issue of one new share for every ten existing shares held by shareholders whose names are on the Register of Members of the Company as at 15th June 2017. The necessary resolution will be proposed at the forthcoming Annual General Meeting on 7th June 2017, and if passed, share certificates will be posted on 23rd June 2017.

Final Dividend

The Directors are pleased to recommend a final dividend of HK23 cents per share payable to shareholders whose names are on the Register of Members of the Company as at 15th June 2017. Including the interim dividend of HK12 cents per share paid on 3rd October 2016, the total dividend payout for the whole year shall be HK35 cents per share. Barring unforeseen circumstances, the forecast dividends per share for 2017 after bonus share issue shall not be less than the interim and final dividends for 2016.

Business Outlook for 2017

The Company predicts steady growth in its number of customers in Hong Kong during 2017. With a small upturn in the total number of inbound tourists in early 2017, the retail market has now improved slightly. The Group's gas business in Hong Kong is also benefiting from the efforts of The Government of the Hong Kong Special Administrative Region to increase land and housing supply which should help maintain stable and good growth in the number of gas customers in the next few years. Additionally, town gas competitiveness as an energy resource combining both environmental and economic advantages is helping to develop the commercial and industrial energy market. Due to the impact of international oil prices, gas tariff fuel cost adjustment charges have been reduced which is beneficial to customers and further enhances the competitiveness of town gas, relative to electricity in particular, in the energy market. However, uncertainties in international politics and the world economy have created variables in Hong Kong's economic development this year. Moreover, increasing local manpower costs and operating expenses are leading to rising costs for businesses in Hong Kong generally. The business environment is full of challenges. The Company will, however, continue to enhance operational efficiency so as to maintain stable development of its gas business in the territory.

Development of export manufacturing industries in mainland China is being negatively affected by uncertainties in both the global economy and the policy direction of a number of major economies. This, combined with other factors including the mainland's slow economic growth momentum, is adversely impacting industrial gas demand. Thus, growth in gas sales of the Group's mainland city-gas businesses is weakening. Coupled with the exchange rate risk arising from renminbi devaluation, overall profit growth of the Group's mainland businesses faces challenges in the near term. Nevertheless, in the long term, the Chinese government's move to improve smoggy atmospheric conditions, thus tightening supervision and administration of related measures and enhancing efforts to reduce carbon emissions and encouraging the use of clean energy, is creating opportunities for natural gas to replace use of coal in industrial processing, as well as in boilers, power generation, distributed energy, household heating, gas hot water heaters and clothes dryers. Natural gas price adjustments in late 2015 lowered upstream gas prices, thus enhancing competitiveness. Furthermore, increasing upstream gas supply, expanding pipeline networks and rapid urbanisation leading to a continuous rise in demand for utility facilities and energy, are all favourable to the development of the downstream gas market and the healthy and long-term development of the natural gas business sector in general.

In respect of emerging environmentally-friendly energy businesses, following the Chinese government's move towards greater energy diversification, environmental protection and recycling of materials, the Group is continuing to develop and apply new technologies for conserving energy and reducing pollutant emissions. There is also a growing trend for greater use of low-sulfur, high-quality oil, electricity and natural gas as fuels for vehicles and vessels to reduce atmospheric pollution. Though international oil prices have recently rebounded from their lowest point in early 2016, it is necessary to closely monitor potential market volatility, as this will still impact profit growth and slow down the pace of investment of the Group's emerging environmentally-friendly energy businesses in the short term. ECO is moving towards production of high-quality chemical products which are less sensitive to international oil prices, taking this as a guide for future project investments. As self-developed research and developments gradually achieve results which will be put into commercial production, emerging environmentally-friendly energy businesses will ignite a new light for the Group, illuminating the way for long-term development and business growth strategy.

With the Group's solid foundation in Hong Kong and its diverse business sectors spread across extensive areas on the mainland, together with its successful technical experience and corporate brand names and sales channels built there over 22 years, alongside society's growing concern over air quality, it is anticipated that there will be ever-rising demand for clean energy. According to the Thirteenth Five-Year Plan, the share of natural gas in the country's total energy mix is set to increase from below 6 per cent currently to 10 per cent by year 2020, thus creating huge market potential for clean energy businesses. In addition, given that the number of piped-gas customers in Hong Kong and mainland China is increasing, the Group, with its sizeable customer base, foresees better benefits from its expanding new businesses.

Despite the challenges resulting from the slowdown in economic growth on the mainland, the Group has formulated, and is gradually implementing, plans in accordance with the country's energy and environmental policies. Overall, with demand for natural gas and environmentally-friendly and renewable energy increasing alongside society's growing aspiration for more environmental protection, coupled with the Group's drive to promote an innovative mindset to continually add new momentum to its business growth, the Group anticipates development in the years to come will be ever broader and better.

LEE Shau Kee
Chairman
Hong Kong, 16th March 2017